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DROUGHT '88

FOOD PRICES
FARM INCOME
EXPORTS

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PERSPECTIVES

U.S. PRODUCTION OF RED MEAT in 1988 is expected to be 3% higher than the 1987 total, while poultry output should be 4% higher. Beef output is likely to be down 1%, pork up 9%, broilers up 4%, and turkeys up 5%.

Overall, red meat and poultry production in 1988 is expected to rise 3%, to a record of more than 60 billion pounds, according to economist Ron Gustafson of USDA's Economic Research Service. The mid-August forecasts of 1988 totals include 23.1 billion pounds of beef, 15.7 billion pounds of pork, 328 million pounds of lamb and mutton, and 399 million pounds of veal, for a total of 39.5 billion pounds of red meat. The expected poultry total, 20.5 billion pounds, includes 16.1 billion pounds of broilers, 3.9 billion pounds of turkeys, and less than 600 million pounds of "other chickens." Expected egg production of 5.7 billion dozen would be 2% lower than in 1987.

In 1989, total red meat and poultry production is expected to decline by 1%. Per capita meat consumption is likely to be lower next year than the 1988 record, but should remain above the large levels of 1985-87. The projections for 1989 production include a 6% decrease in beef, a 1% decrease in pork, a 4% decrease in total red meat, a 4% increase in broilers, a 1% increase in turkeys, and a 4% increase in total poultry.

Cattle numbers may stabilize the next couple of years, resulting in reduced beef production, Gustafson says. Prices of Omaha choice fed steers were at record high levels last spring and should average $69 per cwt this year. Reduced supplies in 1989 may boost prices to $71-$77.

Lower hog prices and higher feed costs are the reasons for the expected decline in hog production. Output in 1989 would still be 8% above 1987, however. Hog prices may average $44 per cwt this year, down from nearly $52 in 1987. Next year's prices, with supplies lower, are likely to average $44-$50.

Broiler production remains profitable, despite higher feed costs, and is thus likely to continue expanding in 1989, Gustafson says. Broiler prices should average 53-56 cents per pound in 1988, up from 47.4 cents in 1987, and are expected to be 51-57 cents in 1989.

Turkey production is expected to show a 5% increase this year, after a 19% gain in 1987. With higher feed costs and continued poor returns, however, the increase in output is likely to be only 1% in 1989.

The retail price of choice beef is expected to increase 3-4% this year and 1-3% in 1989. Retail pork prices should decline about 3% in 1988 and may increase 3-4% next year. Wholesale broiler prices are expected to average about 54 cents a pound both this year and next, and wholesale turkey prices are likely to be 61-64 cents this year and 68-74 cents next year.

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FEATURES

Drought's Effects on Food Prices, Farm Income, Exports *by Eric Van Chantfort* 4

The drought of 1988, one of the worst of this century, has had varying impacts on different sectors of U.S. agriculture and different areas of the country. It's still far too early for a complete accounting, but economists have outlined the possible effects on food supplies and prices, farm income, and agricultural exports.

Lean Beef Making an Impact in the Marketplace *by Juliana King* 10

Beef cuts available in supermarkets are now leaner than in past years, and the cattle industry is working to get that message across to consumers. Producers, too, are learning an important lesson—that it can pay to produce leaner animals. The educational process can be very slow, however.

Iraq's Imports of U.S. Farm Products Up Sharply *by Judith Foulke* 12

Iraq is nearly doubling its purchases of U.S. farm products this year, putting it among our top 10 customers. U.S. credit and export programs are important factors in the increased sales. Other influences: Iraq's long war with Iran, increasing consumer demand, and farm production problems.

EC Boosts Farm Funding, Seeks Production Cuts *by Doug Martinez* 14

The European Community, in an effort to solve a long-standing financial crisis, has increased the amount of funds available for its farm programs. And the EC also is altering some policies in an effort to reduce incentives for overproduction of several commodities. These changes could have a big impact on U.S. farm exports, but the results won't be apparent for some time to come.

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Drought's Effects On Food Prices, Farm Income, Exports

It started early, spread rapidly, and held on with a stubborn resolve. Much of the nation has been caught in its dry, searing grasp.

Many climatologists are predicting that, once final figures for the year are in, the drought of 1988 may rank as one of the meanest of this century. Like a furnace, it dried up ponds and rivers and sucked the moisture from the ground. Pasture and range conditions in early July were the worst since records began in 1921.

As severe, sustained, and widespread as it turned out to be, however, the drought has left major segments of agriculture virtually untouched.

The winter wheat crop, harvested in late spring and early summer, largely escaped damage. Some fruit, vegetable, and cotton producers were hurt, but so much of U.S. production is irrigated or outside the severe drought areas that supplies should be fairly plentiful.

In contrast, the spring wheat crop, harvested in late summer, has been hit hard. So, too, have feed grain and oilseed crops in many parts of the country. Yields and production of corn, sorghum, barley, oats, and soybeans will be down sharply.

The various effects of the drought, from scorched pastures to higher hay and feed prices, are also being felt throughout the livestock sector—beef, pork, poultry, and dairy—but the impacts vary among different areas and different producers.

No doubt, many of the uncertainties related to the drought will only be put to rest with the passage of time. Yet there are several important concerns that can now be addressed with some confidence.

Economists can already offer a preliminary analysis of such questions as: How is the 1988 drought affecting food supplies and prices? How is it likely to affect this year's farm income? How might it affect exports?

On the following pages, we examine these three questions with several economists in USDA's Economic Research Service. For comparison, we also look at data on the effects of the 1980 and 1983 droughts—the first two widespread droughts of this decade. Finally, on page 9, we provide USDA's August projections of 1988 yields, production, food prices, farm income, and exports.

Drought Assessment: Food Supplies and Prices

The drought has affected retail supplies and prices of many foods—sweet corn being one example—but supermarket shelves remain well stocked, and no dramatic increases are expected in the overall cost of groceries at the checkout counter.

"Although grain and soybean stocks are not as large as they were in some prior drought years, we are in no foreseeable danger of running short of food," says ERS economist Ralph Parlett. "Supplies of grains are more than ample to meet demand. We had a good winter wheat crop, and total red meat and poultry production is expected to set an all-time record. Most U.S. fruit and vegetable crops are irrigated and have not been damaged by the drought."

Consumers are also concerned about food prices, of course, and "prices may be rising at a slightly faster rate this year and next than we had expected before the drought," says Parlett. "Historically, though, we have not seen any great impact on food prices because of droughts," he adds.

The assumption that sharp increases in farm prices translate into similar price jumps at the supermarket has a number of faults. In the first place, the "farm value" of foods averages only about 30 percent of the retail price. Thus, a 20-percent across-the-board increase in farm prices—if passed immediately through to consumers—would boost retail prices of domestically produced foods only about 6 percent. And even that would be highly unlikely for several reasons, according to Parlett.

One reason is that food processors and retailers tend to absorb at least some of the changes in farm prices when there are short-term fluctuations associated with disruptions like the drought. When farm prices drop rapidly, the marketing margins usually widen. When farm prices climb rapidly, as they have this year for several crops, margins are squeezed.

Moreover, a drought rarely affects supplies and prices of all food commodities and, for those it does affect, the impacts are rather mixed.

Mixed Impacts

These mixed impacts are usually apparent when contrasting the crops sector with the livestock sector. Farm prices for grains and oilseeds shot upward early in the year in anticipation of reduced fall harvests. In drought years, however, livestock prices generally move in the opposite direction—as they did in both the 1980 and 1983 droughts.

Burnt-up pastures, rising hay prices and local shortages, and dried-up water holes are especially hard on cattle ranchers. Higher corn and soybean meal prices and possible heat stress to animals affect hogs and poultry as well. The result is that more breeding stock is slaughtered, and more meat crowds onto the market in a drought year.

"We're seeing some drought-related slaughter of dairy and beef cows and breeding sows this year," says Parlett, "but not enough to substantially weaken prices. Meat prices have been much stronger than we thought they'd be in the face of record-large 1988 supplies compounded by drought."

Although unrelated to the drought, the expected increase in farm prices for livestock products this year will be much smaller than the increase for crop products. "Since meat accounts for nearly one-third of consumer food expenditures, it will help hold down the overall impact of higher prices for crop-based foods," he says.

Next year is more difficult to predict. With reduced cattle and hog numbers, fewer animals will be available for slaughter,

USDA's August estimates indicated that the national average yield for corn may be down about 34% this year, compared with 28% in 1983 and 17% in 1980.

meat supplies will probably decline, and prices will rise. If feed prices drop, producers will have an incentive to hold back animals to rebuild herds, hoping to capture the higher prices later. Consumers will pay more for meat than would have been the case without the drought.

Grain and oilseed prices, on the other hand, could well turn down in anticipation of increased acreage and larger 1989 harvests, assuming the moisture outlook improves.

This year, says Parlett, the drought's impact on the crops sector may be reflected mainly in two food groups—cereal and bakery products, and fats and oils. Both these food groups are made up of highly processed products, so the farm price is a small component of the retail price.

In 1987, farm value was less than 8 percent of the retail cost for cereal and bakery products, and 18 percent for fats and oils. Farm prices have a bigger impact on retail meat, dairy, and poultry products, where the farm share of 1987 retail costs ranged from 42 percent for dairy to 54 percent for eggs.

Food Prices Rise Every Year

In any case, says Parlett, the overall linkage between changes in farm prices and changes in food prices is a very weak one. Food prices tend to rise every year, even in years (such as 1982) when farm prices drop. In most years, the inflation rate—which makes itself felt in the rising costs of processing and marketing foods—is far more important in determining how much food prices increase.

In the 1980 drought year, food prices increased 8.6 percent, but that was down from 10.9 percent the previous year (when crops were good), and it slowed further the following year—to 7.9 percent. "What happened was that we were getting away from a period of high inflation into a period of recession," says Parlett.

In the 1983 drought year, the low rate of inflation and the decline in livestock prices at the farm level held the food price increase to a modest 2.1 percent—the lowest rate since 1967.

In most years, the inflation rate is far more important than farm prices in determining how much food prices increase.

In May 1988, before the drought was factored into their projections, USDA forecasters were predicting an increase of 2 to 4 percent in this year's food prices, mainly reflecting higher marketing costs. So far, the drought has pushed this forecast range up just one percentage point to 3-5 percent.

The upward pressure on retail prices may affect pasta products (made from durum wheat), vegetable oils (although global oilseed supplies are record large), oat-based cereals, and a few fruits and vegetables, such as sweet corn, peas, dry beans, and tart cherries.

With produce, drought effects were felt mainly in states that grow vegetables for canning, although fresh fruit and vegetable supplies (and quality) have been reduced in some nonirrigated drought areas. In many of these areas, food stores normally depend on local farmers to help fill produce shelves during the summer and fall. As a result, says Parlett, there will be some strain on total vegetable supplies, and prices may be slightly higher than would otherwise be expected.

Drought Assessment: Farm Receipts and Income

"When we try to assess the drought's impact on the farm financial picture, it is important to distinguish between aggregate measures, such as the sector's net cash income, and the distributional impacts on individual farm businesses," says economist Richard Kodl, an ERS analyst specializing in farm income.

The distributional effects will vary greatly from region to region, commodity to commodity, and producer to producer, Kodl notes. Even among feed grain and soybean farmers, the drought's impact is likely to be a very uneven one, depending on such factors as when they marketed their 1987 harvests, when they planted their 1988 crops, subsoil moisture and the frequency and timing of rainfall in their particular area, fertilizer and pesticide applications, access to irrigation equipment, use of crop insurance, and so on.

The farmer who harvests a good soybean crop may count this year as one of the best in recent memory. Another farmer, who may be across the county or across the road, might already be looking to government drought-relief programs as, perhaps, the only recourse in the face of withered fields or distress sales of livestock or poultry.

Comprehensive data on the distributional effects may not be available until next year, when USDA compiles the results of its Farm Costs and Returns Survey for 1988. The survey, which will be conducted in early 1989, will provide the information necessary to analyze the financial impacts of the drought by region and commodity.

"We do know that slightly more than half of U.S. farms are in counties that were suffering severe or extreme drought conditions as of July," says Kodl. "We also know that many financially vulnerable farms are located in drought areas."

The Larger Picture

Although aggregate financial data tend to conceal the drought's widely divergent effects on individual producers, these broader measures are also essential. They provide the larger picture—a perspective recognizing the size and diversity of U.S. agriculture, and its ability to absorb such adversities as drought.

When looking at the aggregate measures, such as farm receipts and farm income, it is important to remember that any changes in the numbers will reflect other factors in

Cattle prices have been surprisingly strong this year, and livestock receipts are expected to rise. Poor pastures and higher feed costs, however, will cut into incomes.

addition to the drought, says Kodl. Even before the 1988 drought became news, forecasters expected crop receipts to increase this year because of stock reductions, stronger demand, and higher prices. These effects will be magnified by the drought.

"In the short run, the demand for agricultural products is relatively fixed, so price increases tend to offset production declines," says Kodl. "In addition, unsold portions of previous years' crops are marketed as prices move up. As a result, it's not uncommon for crop receipts to actually rise during a drought year."

That's what happened in 1980, the first drought of this decade. The fact that it did not happen in 1983 probably had more to do with that year's PIK program, combined with a U.S. recession and weakening exports, than with the 1983 drought.

For individual farmers and ranchers, the drought's impact will be a very uneven one.

Also, as Kodl points out, the 1988 drought struck much earlier than the 1980 and 1983 droughts, so prices of the affected crops will be higher for a larger portion of the calendar year.

With livestock, the pattern is normally reversed. Distress sales from heat, scorched pastures, lack of hay, and higher feed prices boost beef and pork supplies and reduce prices in a drought year. Price declines tend to more than offset the increased marketings, and receipts drop. Livestock receipts were down from the previous year in both 1980 and 1983.

But this year may be different. The cow herd is much smaller than it was in 1980, reducing the likelihood of heavy culling of lower priced, processing-grade beef cattle. Moreover, livestock prices were surprisingly strong during the first half of the year, and receipts will also reflect record livestock and poultry marketings.

With higher crop receipts and the possibility of a modest increase in livestock receipts, overall farm receipts will rise this year, says Kodl. That will not be the case, of course, for many individual farms and ranches in drought-stricken areas.

Payments, Expenses, and Income

Government payments are another important part of the farm income picture. Before the drought, direct government payments to producers were expected to drop by about $3 billion from last year. Potentially, the drought would result in additional sav-

Drought of '88 Offers A Study in Contrasts

For all the damage it has done, the drought of 1988 is a study in contrasts.

It is, on one hand, a harsh reminder that food production is still subject to natural forces that no one can take for granted.

On the other hand, it provides a reassuring measure of the enormous size, strength, and diversity of U.S. agriculture. How else could food supplies remain plentiful in the face of so many withered fields and pastures?

It is both a warning of the limits of current farming technology and a tribute to past progress. Although we remain vulnerable to weather's eccentricities, our vulnerability has been greatly reduced by irrigation, drought-resistant seed varieties, controlled-environment animal housing, and a transportation system that can speed hay and feed to areas in need.

There are those who view the timing of this drought as a cruel irony, coming as it did just as many farmers were regaining their confidence after several years of financial distress. Others hold a different view: Better a drought now than 3 years ago, when debt loads were higher and incomes much lower.

Even among farmers in drought areas, the contrasts abound. There are both heart-rending stories of farmers who lost an entire year's production to the drought, and enviable accounts of those who captured higher prices without suffering any weather losses. After drought assessment tours through the Midwest in July and August, ERS economist Jim Cole reported seeing sparse, heat-stressed cornfields (often with serious rootworm problems, as well) virtually side-by-side with tall, lush, densely packed fields.

Many businesses that serve farmers also felt the heat, as producers in drought areas postponed major expenditures for new machinery and facilities, even for everyday household goods. (In several farming areas, entire communities will suffer.) Other industries—suppliers of seeds and irrigation equipment, for example—are likely to see their sales increase.

For some of our foreign competitors, the U.S. drought means higher world prices for their grain and oilseed exports, and, perhaps, an opportunity to capture a larger share of these

ings as higher prices for supported crops further reduced deficiency payments. However, much of the money that might otherwise go unspent is likely to be shifted into drought-relief programs. In mid-August, a $3.9-billion drought assistance package was signed by the President.

"On the expense side," Kodl continues, "it's a mixed bag. Generally, drought increases some farm production expenses and reduces others." Feed expenses will be up for cattle feeders, hog producers, and poultry operations, while spending on feeder cattle and pigs will probably decline (reflecting weaker prices for feeder stock in response to the increased feeding costs). Seed expenses may rise because some farmers had to buy more seeds to replant their fields. Fuel expenses may drop as a result of smaller harvests, some acreage abandonment, and lower costs for drying corn, but fuel bills for irrigation may increase.

Net cash farm income is basically a measure of cash income minus cash expenses during the calendar year. And a drought can shift net cash income in either direction.

"The effect," says Kodl, "depends on such factors as the magnitude of the production shortfall, the price response, drought-related changes in farm expenditures, and any changes in deficiency payments, drought-relief efforts, or other programs. Many people are surprised at the relative stability in net cash farm income in a drought year."

Net cash farm income increased about $1 billion in the 1980 drought year and dropped about $1 billion in the 1983 drought (and PIK) year. In other words, the overall cash income position of the farm sector was not significantly affected in either year.

Net farm income, by contrast, typically declines sharply during drought years. Because net farm income is a measure of

The drought took its toll on Gary Hegstrom's alfalfa field near Wilton, North Dakota. Many livestock producers in drought areas are concerned about local supplies and prices of hay this coming winter.

markets. Meanwhile, some importing nations will reduce their purchases in the face of the higher prices, trimming food supplies for their populations.

Of course, the drought raises many serious questions that will only be answered with the passage of time: How might this drought affect the financial recovery in the farm sector that seemed to be taking hold last year? And what about next year's weather? Have we entered a dry cycle that could last beyond this year?

Another concern, in the words of one economist, "is that a drought can both quicken and intensify the cyclical nature of agriculture." Short supplies and high prices in one year present the temptation to drop all restraints, sometimes leading to overexpansion in the years immediately following a drought.

The one certainty, it seems, is that the repercussions of this drought will not be confined to a single nation, a single year, or a single sector of agriculture.

Nevertheless, there are those who can find a silver lining in this year's lack of rain clouds. The drought, some say, has helped speed up the reduction in U.S. surpluses that have held down grain prices.

Moreover, the drought has not seriously impaired the ability of U.S. agriculture to meet the needs of domestic or foreign customers. U.S. grain stocks entering the 1988/89 season are equivalent to about 7 months' worth of combined domestic and export use.

In addition, more than 78 million acres of U.S. farmland were removed from production this year by federal programs. As USDA officials point out, some of this land will be eligible for planting under the 1989 wheat program, and the rest serves as a buffer against any prolonged, serious crop shortfalls. This leaves us with a huge capacity to increase food and fiber supplies by returning idled land to production.

Finally, the drought is a further reminder of the unique position of agriculture among America's many industries. The policy debate has not been about whether government should come to the aid of U.S. farmers and ranchers, but rather about procedural issues—how best to provide assistance, how much we can afford to spend, and how to ensure that help is targeted to those who truly need it.

the net value of the current year's production (rather than net cash transactions), it is calculated after adjusting for any changes in farmers' inventories.

If farmers reduce their inventories—typically the case in a drought year—the value of the net inventory reduction is subtracted in calculating net farm income. In that way, the current year's income can be isolated from earnings based on any selloff of inventories that were accumulated from past harvests.

In both 1980 and 1983, net farm income was sharply reduced by large inventory drawdowns, says Kodl. Net farm income dropped from $27.4 billion in 1979 to $16.1 billion in 1980, and from $23.5 billion in 1982 to $12.7 billion in 1983. In each case, it recovered dramatically the following year as production rose and stocks were replenished.

Before the drought hit, forecasters were predicting small to moderate declines from last year's record highs in both 1988 net cash income and net farm income. The forecasts were based on expectations of lower government payments, somewhat higher expenses, and some drawdown in crop inventories.

With the drought, the savings in deficiency payments and the inventory drawdowns are likely to be greater than previously anticipated, but any reduction in government payments will depend on how much of the savings is recycled into drought relief. USDA's latest forecasts (as of August) for net cash and net farm income, receipts, and farm prices are on page 9.

Drought Assessment: Agricultural Exports

Although the 1988 drought hit unusually early in the year, it is not expected to have a major impact on fiscal 1988 U.S. farm exports, says ERS economist Ron Trostle.

By the time prices started to jump, half the fiscal year was already over, and much of the exports for the second half of the year were already contracted and priced. Forecasts before the drought indicated that both export volume and value would rise by an impressive margin this year. That hasn't changed.

What may change is next year's export outlook. Fiscal 1989 begins October 1. "When prices go up, some sales aren't made, and volume tends to drop," notes Trostle.

The value of U.S. exports for fiscal 1989 is more difficult to anticipate. The drought could raise or reduce value, depending on whether price increases are greater or less than the losses in sales volume. USDA's first forecast of fiscal 1989 exports will be issued on November 29.

Yet the risk of forecasting exports based entirely on one event—even one as impor-

Looking Backward: *The Droughts of the Early 1980's*

Although no two droughts are alike, a look back at the droughts of 1980 and 1983 might add some useful perspective to this year's concerns.

Selected Statistics from the 1980 and 1983 Drought Years

	1980 drought			1983 drought[3]		
	1979: year before drought	1980: year of drought	1981: year after drought	1982: year before drought	1983: year of drought	1984: year after drought
Corn yield (bu./acre)	109.5	91.0	108.9	113.2	81.1	106.7
Wheat yield (bu./acre)	34.2	33.5	34.5	35.5	39.4	38.8
Soybean yield (bu./acre)	32.1	26.5	30.1	31.5	26.2	28.1
Corn production (mil. bu.)	7,928	6,639	8,119	8,235	4,175	7,674
Wheat production (mil. bu.)	2,134	2,381	2,785	2,765	2,420	2,595
Soybean production (mil. bu.)	2,261	1,798	1,989	2,190	1,636	1,861
Beef prod. (bil. lbs.)	21.4	21.6	22.4	22.5	23.2	23.6
Pork prod. (bil. lbs.)	15.5	16.6	15.9	14.2	15.2	14.8
Poultry prod. (bil. lbs.)	14.3	14.5	15.3	15.4	15.8	16.4
Farm prices (% change)	+14.8%	+1.5%	+3.7%	-4.3%	+1.5%	+5.2%
Crop prices (% change)	+10.5%	+7.8%	+7.2%	-9.7%	+5.8%	+7.8%
Livestock prices (% change)	+18.5%	-2.0%	-0.7%	+1.4%	-2.8%	+3.5%
Food prices (% change)	+10.9%	+8.6%	+7.9%	+4.0%	+2.1%	+3.8%
Inflation rate (% change)	+13.3%	+12.4%	+8.9%	+3.9%	+3.8%	+4.0%
Crop receipts ($bil.)	$62.3	$71.7	$72.5	$72.3	$67.1	$69.4
Livestock receipts ($bil.)	$69.2	$68.0	$69.2	$70.3	$69.4	$72.9
Net cash farm income ($bil.)	$33.4	$34.2	$32.8	$38.1	$37.1	$38.8
Net farm income ($bil.)[1]	$27.4	$16.1	$26.9	$23.5	$12.7	$32.0
Export value ($bil.)[2]	$32.0	$40.5	$43.8	$39.1	$34.8	$38.0
Export volume (mil. tons)[2]	137.4	163.5	162.0	160.2	147.1	145.9

[1]Includes inventory adjustment. [2]Data for fiscal years. [3]1983 was also the year of the PIK program, which compounded the effects of the drought in reducing crop production.

tant as the drought—is that other important supply and demand factors may be missed, says Trostle.

Clearly, other factors were at work in the first two droughts of this decade. The 1980 drought occurred near the peak of the long-term upward trend in exports, and the next drought hit after U.S. exports had already gone into decline. Export earnings reflected the value of the dollar, strength or weakness in the world economy, U.S. price supports, Third World debt, and so on.

Looking back to the 1980 drought, U.S. export value climbed sharply from 1979 to 1980 and then set another record—which still stands—the following year. In the 1983 drought (and PIK) year, export value declined but then bounced back up in 1984.

What About This Year?

Here are USDA's mid-August forecasts of yields, production, and end-of-season stocks for corn, wheat, and soybeans, plus forecasts of meat production. The three previous years are included for comparison. The forecasts are based on conditions through early August and do not make any assumptions about further weather abnormalities.

Crop Yields

	1985	1986	1987	1988 forecast
	bushels per acre			
Corn	118.0	119.3	119.4	78.5
Wheat	37.5	34.4	37.6	34.4
Winter wheat	38.1	35.2	39.8	39.2
Durum wheat	36.4	34.0	28.2	18.5
Other spring	35.4	32.3	33.7	20.6
Soybeans	34.1	33.3	33.7	26.0

Crop Production

	1985	1986	1987	1988 forecast
	millions of bushels			
Corn	8,877	8,250	7,064	4,479
Wheat	2,425	2,092	2,105	1,821
Winter wheat	1,828	1,521	1,563	1,555
Durum wheat	113	98	93	55
Other spring	485	472	450	212
Soybeans	2,099	1,940	1,905	1,474

Year-End Stocks

	Marketing years			
	1985/ 1986	1986/ 1987	1987/ 1988	1988/ 1989 forecast
	millions of bushels			
Corn	4,040	4,882	4,352	1,576
Wheat	1,905	1,821	1,266	597
Soybeans	536	438	280	100

Meat Production

	1985	1986	1987	1988 forecast
	billions of pounds			
Beef	23.7	24.4	23.6	23.2
Pork	14.8	14.1	14.4	15.7
Poultry	17.3	18.2	20.1	20.8

Here's how the projected changes in 1988 yields and production compare with those of 1980 and 1983. The changes shown are from the previous year—1979 to 1980, 1982 to 1983, and 1987 to 1988:

	1980	1983	1988
Corn yield	-17%	-28%	-34%
Wheat yield	-2%	+11%	-9%
Soybean yield	-17%	-17%	-23%
Corn prod.	-16%	-49%	-37%
Wheat prod.	+12%	-12%	-13%
Soybean prod.	-20%	-25%	-23%

Here are USDA's August forecasts of prices, farm receipts, farm income, and exports for 1988. For some indication of how the drought has affected this year's prospects, we have also included the pre-drought forecasts made last May. It is important to note, however, that projections are normally adjusted as the year progresses—with or without drought. Thus, any changes between the May and August forecasts cannot be attributed solely to the anticipated effects of the drought.

Selected Forecasts for 1988

	1985	1986	1987	1988 May forecast	1988 August forecast
Farm prices (% change)	-9.9%	-3.9%	+3.3%	+0.8%	+7.9%
Crop prices (% change)	-13.7%	-10.8%	-0.9%	+4.7%	+17.0%
Livestock prices (% change)	-6.8%	+1.5%	+5.8%	-1.4%	+2.1%
Food prices (% change)	+2.3%	+3.2%	+4.1%	+2-4%	+3.5%
Crop receipts ($bil.)	$74.2	$63.6	$61.9	$64-67	$66-68
Livestock receipts ($bil.)	$69.8	$71.5	$76.2	$71-74	$77-79
Net cash farm income ($bil.)[1]	$46.6	$51.4	$57	$50-55	$55-60
Net farm income ($bil.)[1]	$32.3	$37.5	$46	$40-45	$38-43
Export value ($bil.)[2]	$31.2	$26.3	$27.9	$33.5	$34.0
Export volume (mil. tons)[2]	126.0	109.9	129.2	145.5	146.0

[1]1987 figures are preliminary. Net cash farm income is a measure of cash earnings after cash expenses. Net farm income is a different measure, incorporating the value of inventory changes, noncash income, and noncash expenses, such as depreciation. When inventories are reduced—usually the case in a drought year—sales from inventories raise net cash farm income. In calculating net farm income, however, the value of the inventory reduction is subtracted. [2]Fiscal years.

Market Shares Are a Concern

One important concern with any runup in price, or tightening in exportable supplies, is U.S. market shares. With lower prices and new export programs, the United States has started to regain market shares lost to our competitors during the first half of the 1980's.

The U.S. export recovery is now barely 2 years old—not the time, it would seem, for a drought. Also, foreign supplies of grains and oilseeds are expected to be fairly large in the year ahead, meaning strong competition for export markets. Yet Trostle's perspective on market shares is instructive.

Yes, higher prices and tighter supplies may cause us to lose some market share in fiscal 1989, he says. With soybeans, for example, Brazil and Argentina can be expected to boost their acreage, perhaps substantially, in response to the strong price incentive—though steady expansion was already occurring in both countries.

On the other hand, he contends that one year of higher prices and lower U.S. output is not likely to initiate any major changes in world production patterns or any dramatic increases in agricultural investment abroad.

"Look how fast we came out of past droughts," he says. "We may lose market shares because of higher prices and limited exportable supplies in the year ahead, but we'll be back in those markets in the following year if our '89 harvests are normal. The huge productive capacity of the United States, the cheaper U.S. dollar, and our ability to put ARP acres back into production are all in our favor."

Trostle also points out that next year's market share might have dropped anyway because a large portion of the recent gains have been based on substantial price discounts through the Export Enhancement Program. □

Lean Beef Making an Impact In the Marketplace

When consumers go shopping for lean meat, the beef industry wants its products on their lists. That means two things—getting the message to consumers that beef cuts are getting leaner, and getting the message to producers that it pays to turn out leaner cattle.

It may not be easy to change consumer perceptions about the relationship between red meat and fat, but the industry recently got some good news. On May 10, cattle producers approved a check-off of $1 per animal sold, marking the first time producers voted nationwide to fund beef promotion and research. Recent national beef advertisements were paid for by a check-off that was legislated by Congress pending a producer referendum.

The check-off funds will come in handy in publicizing the results of a USDA-industry survey that confirms that the fat content of beef has dropped. The study was conducted by Texas A & M University and sponsored by USDA's Agricultural Research Service, the National Cattlemen's Association, The National Live Stock and Meat Board, and the Cattlemen's Beef Promotion and Research Board. It indicates that between 1976 and the study periods of October-November 1987 and February 1988, fat levels in retail cuts dropped 27 percent, while levels in choice beef carcasses were down 8 percent.

Whether this information will influence consumer demand for beef is uncertain. As economists Larry Duewer and Ken Nelson of USDA's Economic Research Service say, it is difficult to measure consumer perceptions, much less how such perceptions affect demand.

Trimming at Retail

More easily measured are the effects of the recent record large supplies of pork and poultry and the relatively higher prices for beef. This mix of market factors has played a major role in the decline of beef's market share since the late 1970's.

One thing is certain. Given that most of the decline in the fat in beef came as a result of greater trimming of fat at wholesale or retail, further declines will have to come elsewhere in the production process. As Jeff Savell of Texas A & M says, the biggest reduction occurred at retail. The study shows that 40 percent of the cuts sold in the stores in the survey had no external fat at all. These were cuts like stew meat, flank steaks, and even some chuck roasts. According to the survey, most cuts were trimmed to one-quarter of an inch of fat or less. Many were trimmed to one-eighth inch.

Fat levels in retail cuts dropped 27 percent, while levels in choice beef carcasses were 8 percent less.

In other words, consumers are no longer buying the fat they probably would have trimmed off. It is being trimmed for them prior to sale, primarily at the retail level, but also to some extent at the processor level, says Duewer.

The move toward leaner beef has been slow. Much of the impetus for closer trimming came from the 1986 government and industry funded National Consumer Retail Beef Study, which found consumers thought well-trimmed beef was more appealing.

But retailers can only trim so much, and few can afford the cost of paying for that waste, the economists say. Consequently, if the demand for lean beef continues to grow, retailers will pressure processors and packers to provide boxed or carcass beef that has less fat. The processors will have to adjust, say Duewer and Nelson.

Like retailers, processors will be less willing to absorb the cost of paying for fat left on the trimming floor. Processors have already started to select animals with higher cutability (a higher ratio of meat to fat and bone) that are likely to yield meatier carcasses. As a result, animals that yield poorly may be docked at the live level, leaving producers to absorb the cost of waste fat, say the economists.

How can such changes in processor preferences be tracked? One way is to look at the differences in what processors pay for cattle based on yield grades (YG). YG 4 and 5 animals have relatively more fat, and therefore less meat. YG 1 and 2 are at the top of the scale with the least fat. They also tend to have the highest percentage of lean meat. On average, processors currently pay cattle producers more for YG 2 and 3 cattle than for YG 4 and 5. The few YG 1 cattle that are marketed are typically priced with YG 2 cattle, says Nelson.

But yield grades are not the only factors involved. Quality grades—the classifications prime, choice, and select (formerly good) which were coupled with yield grades in 1976 as part of an overall grading system change—also play a role in what farmers receive for their cattle.

Measuring Quality Grades

Under the current grading system, producers are encouraged to feed cattle to the choice or prime grades because they receive premium prices for such cattle, says Texas A & M's Savell. By feeding to the higher quality grades, many producers are putting more waste fat on their cattle.

Marbling—the white flecks of fat within the muscle tissue—is one of the measures of quality grades and has been one of the reasons producers feed cattle to heavier weights. This is because increased marbling in beef has long been associated with greater tenderness, juiciness, and flavor in beef, explains Nelson.

Another factor influencing heavier and fatter cattle has been the industry's emphasis on dressing percent. Aside from the yield and quality grades, producer prices are based on the weight of the carcass. The problem with this, says Savell, is that it promotes fatter cattle because the major way to increase dressing percent is to add fat.

Since the industry's profitability depends on the number of pounds bought versus the number sold, it would be more equitable to tie the live animal more directly

to its boxed-beef yield, Savell says.

But if the producer side of the industry is going to shift to leaner, meatier animals, farmers must have an economic incentive to raise such cattle.

Prior to World War II, hogs produced on U.S. farms were considerably fatter than their modern cousins. But as the needs and demands of consumers changed, and lard was replaced by vegetable shortenings, it was no longer economical to feed hogs to the degree the industry was accustomed. Processors began to dock the price on hogs that they thought were too fat, and producers had an incentive to produce meaty hogs instead of fat ones, explains Duewer.

Today, hogs are generally longer and have less backfat. They are also more smoother muscled than their ancestors, all traits that contribute to greater cutability, Duewer says.

However, cattle have a much longer life cycle. It takes 18-24 months for a newborn calf to reach market weight, whereas hogs reach market size in 5-6 months. In addition, while sows produce about seven pigs a litter and two litters a year, cows usually produce only one calf per year (twins are uncommon). Therefore, it takes longer for genetic progress to be made, Nelson says.

A Sharp Contrast

The cattle industry could follow the same path the hog industry has, and cattle could become leaner. In fact, the industry has already seen some change. A comparison of the type of cattle that competed in the show ring during the 1950's and the type that win blue ribbons today provides a sharp contrast. For example, the fed, or fattened, steers that won state and county fairs three decades ago were much smaller and much fatter than today's show champions.

A review of the changes in the yield grades of animals slaughtered also confirms that today's cattle are leaner, says Nelson. In 1976, only 29 percent of the graded steer and heifer beef fell into YG categories 1 and 2, the meatiest grades. By 1986, around 46 percent of the graded steer and heifer beef was classified YG 1 and 2.

Commercial cross breeding incorporating the larger, generally leaner exotic breeds with the better marbling British breeds has increased the average size of animals going to slaughter. Nelson says that slaughter-weight heifers had average carcass weights of 580 pounds in 1976, while in 1987 they weighed 648 pounds. Steer carcass weights rose from 695 pounds to 717 pounds.

Artificial insemination, super-ovulation, and embryo transfers have also spurred development of breeds that are meatier and faster growing. Products that promote development of muscle and leaner meat in cattle exist and are in use. In the future, developing technologies, like bovine somatotropin, may help animals produce even more lean tissue.

However, the trend toward leaner animals depends primarily on whether it is profitable for farmers to produce lean cattle. Producers will adjust what they produce to what they can sell most profitably, says Nelson.

"Producers will grow the kinds of animals that will make them the most money. As long as it pays them to put weight on, whether it is meat or fat, producers will continue to feed their cattle," he says. □

Yield Grade 2 Accounts for a Larger Share of Graded Steer and Heifer Beef Than It Did in the Past

	YG 1	YG 2	YG 3	YG 4 & YG 5
	percent of lbs. in grade[1]			
1976	1.5	27.5	59.3	11.7
1978	2.0	30.1	58.8	9.1
1980	1.6	28.7	58.5	11.2
1982	2.0	32.5	56.2	9.3
1984	3.5	42.0	49.5	5.0
1986	4.0	41.7	49.0	5.3
1987	3.7	41.6	49.4	5.3

[1] Numbers include only those cattle that were USDA graded.

More consumers are choosing lean cuts of beef.

Iraq's Imports of U.S. Farm Products Up Sharply

In a few short years, Iraq has turned into one of the biggest customers for U.S. agricultural exports. The reasons: more U.S. credit and the Export Enhancement Program, coming at a time when a growing Iraqi population, farm production problems, and war with Iran have boosted food import demand.

This year the United States is likely to sell about $1 billion in farm products to Iraq, with rice, corn, and hard red winter wheat topping the list. That's nearly double last year's sales, and it will put Iraq among the top ten U.S. markets for 1988.

Analysts say that as long as U.S. credit is available and Iraq's economy continues to expand, the Iraqi market for U.S. agricultural products will stay strong.

John Parker, an economist with USDA's Economic Research Service, explains that officials in Iraq have searched for more and larger suppliers to improve living standards and to fill the increasing demand for food. Iraq regularly imports 60 percent of its food, but war with Iran has disrupted traditional supply lines. The loss of its Persian Gulf ports caused Iraq to shift from suppliers who used those ports. Suppliers must now be willing and able to ship to ports in Turkey, Jordan, and more recently, Kuwait.

But war-related disruptions are not the only reasons that Iraq needs more food. Iraq's population has grown 3 percent annually since the 1970's, and agricultural production has not kept pace. Even with imports, grocery store shelves in Baghdad and Basra are mostly bare.

Also contributing to the increased need for food are the changes in Iraq's economic policy since 1984. Iraq's shift from a totally nationalized system to the beginnings of private enterprise in certain food marketing and processing areas, such as soft drinks, has opened a market for increased and more diversified imports.

Urbanization, improved internal marketing systems, and the extension to rural areas of food subsidy and distribution programs, once available only in major cities, have also contributed to the increased demand for food, says Parker.

Sales of farm products to Iraq will nearly double last year's total, putting Iraq among the top ten U.S. markets.

Iraq's consumption of agricultural products is growing faster than its production. New irrigation projects helped Iraq produce more rice and cotton in 1987, but the gains were small in relation to total demand.

Though overall crop production was down in 1987 because of drought, use of imported feed allowed livestock production to rise enough so that total agricultural output registered a slight gain. Favorable weather in 1988 allowed a rebound in wheat and barley production, but per capita food production is still below the level of a decade ago.

Sales Spurred by Credit

The United States responded by offering over $1 billion worth of credit guarantees to Iraq this year through the GSM 102 and 103 programs. These are U.S. Treasury guarantees for commercial credit repayable in 3 and 7 years, respectively. By summer, Iraq had used two-thirds of the available credit.

Iraq is the top credit buyer from the United States. The availability of credit appeals to Iraqi financial planners, says Parker, because of Iraq's current shortage of foreign exchange and its favorable prospects for future petroleum exports. (Recently, the Iraqis retook and repaired the petroleum pipeline that had been lost to Iranian military attacks.)

Parker says that Iraq has had a good record of loan repayment. Money to pay off loans from the United States comes mostly from the sale of oil. Iraq's oil reserves are second only to Saudi Arabia, and Iraq is a leader in keeping the price of oil low.

But ample credit is not the only reason Iraq turns to the U.S. market, says Parker. "The United States has what Iraqi food buyers are looking for: an abundant supply of commodities, good management in purchase negotiations, and competitive prices as a result of the U.S. Export Enhancement Program (EEP)."

Iraq has started a policy of giving careful consideration to the unit cost and efficiency of delivery of its imports. Because the United States has the capacity to export abundant quantities of commodities, Iraq can purchase large volumes more efficiently than it can by purchasing smaller amounts from more countries. Shipping and handling costs are also proportionally lower with larger shipments.

Purchases of agricultural products from some other countries have encountered financial problems and interruptions due to inadequate supplies for export. Iraq has recently reduced imports from the European Community and Brazil. Difficulties concerning oil barter agreements with Turkey, and the instability of the Turkish lira, caused imports from that country to decrease from $346 million in 1984 to less than $120 million in 1987, and much of this gap is being filled by the United States, says Parker.

EEP Makes Trade Attractive

The advantage of competitive prices offered through the EEP, combined with GSM credit guarantees, has made trade in U.S. commodities attractive to Iraq. Use of the EEP helped to lower the price Iraq paid for U.S. wheat from $122 per ton in 1986 to $93 in 1987.

ERS analysts expect U.S. sales of wheat to Iraq to increase at least 25 percent to over 1 million tons this year. Iraq ranks second to the Soviet Union in purchases of hard red winter wheat from the United States.

U.S. exports of wheat flour will not do as well. Iraq is reducing wheat flour imports because of increased processing capacity in its own mills.

In 1987 Iraq purchased 60,000 tons of poultry through EEP because gains in domestic production were not sufficient to

cope with rising consumption.

Eggs are another commodity benefiting from sales through the EEP program. Iraq purchased $16.7 million worth of U.S. eggs in the first 8 months of fiscal 1988. Turkey had been Iraq's leading supplier because it has the advantage of a nearby location with convenient truck delivery. However, trading problems with Turkey caused Iraq to place a higher priority on its own production, supplemented by imports from the United States.

Other U.S. Programs Encourage Trade

A combination of credit and low prices offered through EEP and the Dairy Herd Buyout Program contributed to U.S. sales of 6,058 head of dairy cattle, valued at $8 million, to Iraq. The sales occurred in 1987, but most of the deliveries were made in early 1988.

In addition, Iraq has bought over $12 million worth of butter, cheese, and powdered milk from the Commodity Credit Corporation's dairy program. Early purchases, before the program stocks started to dwindle, enabled Iraq to buy the commodities at one-fourth below the price that these commodities were offered later in 1988.

Iraq remains the top export market for U.S. rice, though the quantity may decline from 508,545 tons in 1987 to 450,000 tons in 1988. The doubling of U.S. rice prices from 1987 to 1988 created problems for Iraq's public procurement specialists, says Parker. Iraq had planned to buy about 500,000 tons of U.S. rice in 1988, but higher prices will push the bill to more than $200 million compared with only $118 million in 1987 and the original 1988 credit allocation of only $110 million.

Although Iraq has now received additional GSM 102 credit for rice, a temporary shortage of credit led to purchases from other suppliers.

Iraq is expected to use all of the $64 million credit available for corn in 1988 and almost all of the $65 million credit for soybean meal. Also, $91 million in credit for mixed animal feed will contribute to the jump in purchases of feed grains from the United States. ERS forecasts show that Iraq is expected to exceed its 1984 peak of 934,000 tons in total feed grain imports because its public trading firms want to provide more feed for poultry projects.

U.S. exports of sugar to Iraq rose 81 percent in 1987, to $29 million in value. Credit is available in fiscal 1988 for $68 million. Supplies from India and Thailand, which entered through Gulf ports, encountered difficulties.

Other U.S. commodities that analysts expect will do well in the Iraq market are: dry peas and beans, expected to double the 1987 total; vegetable oils, expected to repeat the 25-percent increase achieved in 1987; and tallow. Rapid expansion of soap manufacture and credit problems with Turkey, Iraq's former major supplier, pushed U.S. tallow exports to $5 million in the first 6 months of fiscal 1988.

U.S. exports of tobacco to Iraq are rising sharply in fiscal 1988, and the credit line of $30 million has already been used. New brands of cigarettes containing U.S. tobacco are popular, and imported cigarettes are scarce.

New Trade Opportunities

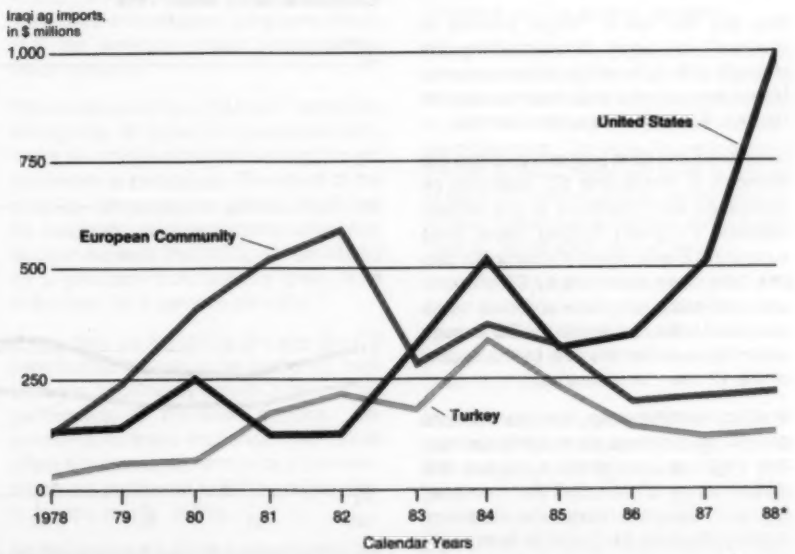
The first U.S. exports of cotton and wool occurred in fiscal 1987, with cotton shipments valued at $12 million and wool at $3 million. ERS data show that demand for cotton and wool is rising fast because Iraqi textile factories are expanding output. Purchases of $51 million worth of U.S. cotton and $4.5 million worth of wool have been arranged for 1988.

Parker says that diversification of U.S. agricultural exports to Iraq is expected to continue. There is a potential market for more U.S. processed foods if credit terms are appealing. In addition to the current growth in sales of cereals, frozen poultry, and agricultural raw materials for factories, Iraq could become a significant market for U.S. high-value products such as apples, pears, dried apricots, prunes, raisins, peanuts, and frozen turkeys, says Parker.

The Iraqi government's plans to revive agricultural development have also created a need for more U.S. technical services and agricultural inputs, says Parker. U.S. firms have been active in providing grain storage facilities and seed for Iraqi farmers. A $12 million credit allowed Iraq to use some of the best varieties of tomatoes and melons to improve yields. □

[Based on information provided by economist John Parker of the Agriculture and Trade Analysis Division, Economic Research Service.]

The United States Has Taken a Wide Lead Among Iraq's Three Largest Suppliers of Agricultural Imports



*Projected.

EC Boosts Farm Funding, Seeks Production Cuts

The European Community says it has finally found the solution to a long-standing financial crisis that, at times, seemed to jeopardize its extensive agricultural support policies.

Part of the solution involves farm program alterations that may, if effective, reduce some of the incentives for overproduction in the EC.

The other part, however, involves budgetary reforms that will increase the EC's ability to fund its Common Agricultural Policy (CAP). These changes will permit an increase of up to $10 billion from last year's spending level.

With the increased funding, the EC may be taking the edge off U.S. policies that have had the effect of raising EC farm support costs. Under the 1985 farm bill, U.S. loan rates for major commodities were lowered, removing a price "floor" that had kept world prices at artificially high levels. At the same time, the U.S. dollar weakened, making U.S. prices even more competitive. All this, in turn, brought down world market prices, raised the level of EC export subsidies, and made the EC's high price supports much more expensive to maintain.

Now the EC has a "major infusion of revenue" to spend in maintaining the strength of its farm sector, says economist Mark Newman, who until recently was with USDA's Economic Research Service.

Meanwhile, the farm program changes are intended to insure that EC spending on agriculture won't continue to rise without restraint. Programs limiting future price supports in a wide range of commodity sectors have been approved by EC officials. Land set-aside programs will also be introduced for the first time in the EC through action taken earlier this year by the leaders of the 12 member countries.

In effect, says Newman, the recent actions give EC policymakers some additional tools that might be used to cut surpluses and restrain expenditures, but the increased financial resources reduce the short-term pressure to make fundamental farm policy reforms.

With its increased funding, the EC may be taking the edge off of U.S. policies that have had the effect of raising EC farm support costs.

Supporting the Spending Spiral

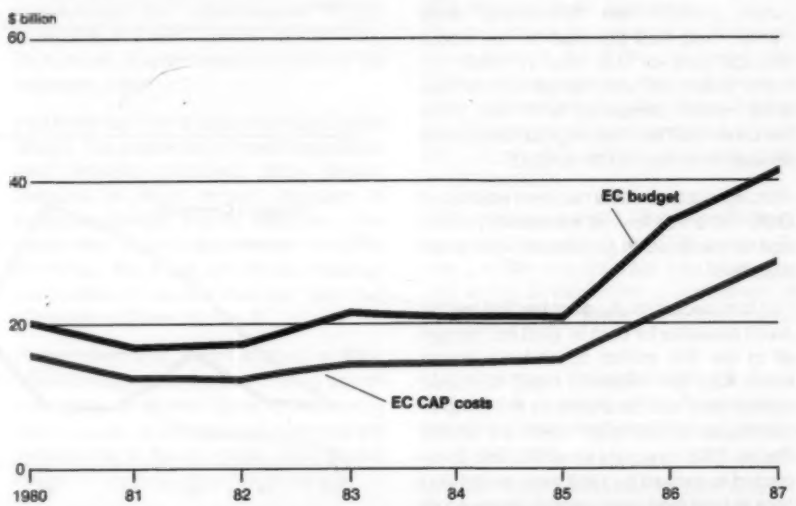
EC spending on agricultural support has risen sharply since 1985, when it was $15.7 billion. Before the U.S. drought raised world prices for many commodities, EC spending was projected to reach the equivalent of 38 billion U.S. dollars in 1988. The decline in the exchange value of the U.S. dollar since 1985 exaggerates the growth, yet even constant-dollar figures show a 50-percent rise in EC spending over that period.

The increased expenditures for EC agriculture came in the wake of four major events: the fall in the value of the dollar, growing EC commodity surpluses, lower world commodity prices (caused in part by lower U.S. loan rates) that pushed up the cost of EC export refunds and processing subsidies, and enlargement of the EC to include Spain and Portugal in 1986.

"Some temporary relief from budget problems had come from special accounting procedures, such as delay of reimbursements to member governments from one year to the next and failure to depreciate stocks to reflect their sales value," says Newman, "but no solution had been found to their underlying causes."

Now the budget balancing problem appears to have been solved, at least for the time being. And while EC officials tinker with some specifics of the revised CAP mechanisms, they have already agreed on the measures that will be used to increase revenues to pay for CAP and limit future expenditure growth.

European Community Spending on Agriculture Has Climbed Sharply Since 1985*



*Based on EC statistics in European Currency Units (ECU's), converted into U.S. dollars. The weaker U.S. dollar since 1985 inflates the growth of the EC budget. The ECU exchange rate is figured at .81 of a U.S. dollar, as of June 1988.

On the revenue side, the basis for computing each nation's contribution to the EC budget has been changed. Contributions had been based on a percentage of the value-added tax (VAT) base. EC governments collect revenues on all products sold using a VAT, which is somewhat akin to state sales taxes in this country.

With the recent agreement, each nation's obligation will shift from 1.4 percent of its VAT base to 1.2 percent of its gross national product (GNP). That, says Newman, is roughly equivalent to 2 percent of the VAT base, meaning more money flowing into the EC treasury.

The EC budget (70 percent of which goes to pay for agricultural programs) is also supported by customs duties, import levies on agricultural products, and levies on sugar and isoglucose.

Limiting Future Spending Growth

On the spending side, says Newman, the price-support portion of the CAP is to be limited to $33.8 billion for 1988, with future annual growth limited to 74 percent of GNP growth. If GNP increases by 1 percent, for example, price support or "guarantee" spending can increase by 0.74 percent.

Moreover, the 1988 budget includes $1.5 billion for commodity stock depreciation, $1.2 billion as a reserve against adverse exchange rate movements, and $1.6 billion for "structural" support measures.

By 1992, the EC Commission forecasts that the limit on EC agricultural expenditures will be almost $43 billion in 1988 U.S. dollars.

But even the higher limit might not be enough, says Newman, without the EC measures approved this year to slow spending growth on a wide range of farm commodities. It is these measures, he says, that hold the potential for slowing the growth in EC surpluses, depending on how effectively and enthusiastically they're applied.

"For grains," says Newman, "the EC has established a limited system of automatic price stabilizers, which require that if production exceeds a maximum guaranteed quantity (MGQ) of 160 million tons, support prices shall be reduced in the following season by 3 percent." For 1988 only, a producer tax equivalent to 3 percent of the support price is being collected, and will be refunded if grain production is less than 160 million tons. EC production totaled 153.4 million tons last year and is forecast to reach 158.5 million tons this year.

For oilseeds, he goes on to say, "support prices are to be reduced in the year that production is forecast to exceed the maximum guarantee quantities." In the 1988/89 season, the "guarantee" threshold—beyond which supports would be lowered—is set at 9.2 million tons. Oilseeds production was 11.9 million tons in 1987/88.

A new land set-aside program may also limit production to some extent, Newman says, and the growth in EC spending for CAP will be cut back a little by the new producer co-responsibility levy (tax) on grains, which is added to one already in place.

Analyzing the Potential

Newman says analysis of "the long-term impact on EC wheat surpluses of the stabilizers and set-aside programs shows that the programs could potentially be made effective."

The crucial point here, he says, "will be the willingness of individual governments to make set-asides attractive enough to get producers to participate. The effect of the stabilizer programs for grains, which call for automatic price reductions when production exceeds the MGQ, will be limited by a provision that restricts grain price reductions to 3 percent annually."

It may also be limited by the way the EC permits adjustments in the exchange rates between its currency unit (ECU's) and the currencies of member nations. Adjustments in these exchange rates could offset any mandated farm price reductions, which are measured in ECU's rather than in francs, marks, or lira.

So far, the impact of the set-aside program is an open question, too.

"EC nations are required to make a paid set-aside land program available," says Newman, "but the participation of farmers is voluntary. Member nations are still deciding on national program details, so 1989 crops will be the earliest that can actually be limited by set-asides."

Unlike the U.S. set-aside program, Newman notes, eligibility for the price and income supports provided by the CAP is not tied to producer participation in the set-aside, so that the primary incentive for participation will be a cash payment.

"The amount of the payment can vary by country and region from $50 to $350 per acre and is supposed to reflect differences in land productivity and income losses," says Newman. "In order to participate in the set-aside, farmers will have to sign up at least 20 percent of their arable land for at least 5 years, although the commitment may be terminated after 3 years."

A further incentive for participation, he says, is that farmers withdrawing 30 percent of their land will be exempt from co-responsibility levies on the first 20 tons of grain that they market.

The set-aside program will be partly financed by EC member nations, with the EC budget providing a share that progressively falls from 50 to 15 percent as the per acre payments increase. Thus, the higher the payment, the greater the share that will have to be borne by the individual

government. This funding method, says Newman, may tend to discourage very generous programs that would insure large participation by European farmers.

In any case, the amount spent by EC members for payments will not show up in the EC budget and will not be counted against the new limit on agricultural spending.

Not All Nations Equally Receptive

Some nations within the EC are expected to be more receptive than others to the new arrangement.

"On the basis of preliminary reactions to the program, it appears likely that national programs will encourage participation in West Germany and the United Kingdom, while interest in southern Europe will be much lower," Newman says. "Since France, the United Kingdom, West Germany, and Italy produce over 80 percent of the EC's wheat and more than 70 percent of its grains, participation rates in these countries will be critical to the success of the program."

Whether the program works may hinge on how closely it applies the lessons learned by U.S. experience with set-asides.

"Estimating the probable impact of the EC's set-aside program requires important assumptions about sign-up and the productivity of land that is put into the program," Newman says. "U.S. experience with both general area set-aside programs and crop-specific acreage reduction programs (ARP's) may provide useful insights. ARP's have been considered more successful than general set-asides as production control devices because they divert land from specific crops that may be in surplus."

U.S. experience also indicates, Newman says, that the effectiveness of ARP's is reduced by "slippage"—reductions in production that are smaller than reductions in planted area. "Slippage" occurs when producers increase production on land not enrolled in the program and remove lower yielding land from production.

"In the United States," says Newman, "slippage can be largely attributed to increased planting by nonparticipants. When earlier U.S. area reduction programs failed to place strict limits on use of diverted land, the substitution of one commodity for another—with little change in harvested area—was also a problem. More recent U.S. programs have taken care not to allow this to happen."

The EC will have to resolve these issues if its set-asides are to contribute to cutting

U.S. Selling More Farm Products to EC

The European Community was first formed in 1957 by six nations: Belgium, France, Italy, Luxembourg, the Netherlands, and West Germany. In 1973, Denmark, Ireland, and the United Kingdom joined, followed by Greece in 1981. Spain and Portugal signed on in 1986, bringing the EC to its current complement of 12 nations.

To date, agriculture has been the most significant measure of cooperation among EC nations.

Placing producers under a centralized Common Agricultural Policy (CAP), the EC has striven almost from the start to guide its agricultural economy to growth and prosperity. It has succeeded, largely by using a mix of farm supports and export subsidies, in strengthening its farm sector and securing a solid share of the world's export markets.

That success seems to be continuing, according to the most recent figures available.

In 1986, EC exports grew by almost a fourth to more than $91 billion. This figure includes trade among EC members, which accounts for about 70 percent of total EC farm exports.

The United States was a large buyer, importing $4.16 billion worth of farm goods from the EC in 1987. Major purchases included tobacco, and fats and oils.

EC nations are also a large market for U.S. farm products—the largest, in fact, when the EC is considered as a single market.

After dipping from the levels of the early 1980's, U.S. farm sales to the EC are climbing again.

"Growth of about 5 percent in fiscal 1988 is expected to push exports to the EC to above $7 billion," says former ERS economist Mark Newman. "Competitive U.S. prices, the cheaper U.S. dollar, and moderate income growth and slight employment increases in the EC are all expected to contribute to the stronger market."

Among the gainers: U.S. rice, fruits and nuts, and cotton.

"Higher rice prices and reduced supplies in a number of Asian countries are likely to boost U.S. rice sales to the EC," says Newman. "U.S. exports of fruits, nuts, and related products to the EC are expected to rise substantially in fiscal 1988. In the first 5 months of fiscal 1988, the value of U.S. exports of fruits and preparations were up 27 percent. Nuts and preparations were up 45 percent over the same period."

High-value fruit and nut sales were buoyed by "abundant U.S. supplies and a range of promotional activities by U.S. trade associations and exporters."

U.S. cotton sales are also up.

"After a strong recovery in fiscal 1987, U.S. cotton exports rose sharply during the first 5 months of fiscal 1988, and are expected to show further increases by the end of the year," says Newman.

surpluses. The alternative, if surpluses continue to build, may be politically unthinkable, says Newman.

"The combination of a set-aside program with sufficient incentives to encourage large participation rates and an automatic stabilizer program has the advantage of permitting EC policymakers to avoid the politically difficult task of major annual farm price cuts," he says. "However, with farms in the EC averaging only 42 acres, it remains to be seen whether the amounts EC member nations are willing to offer farmers to set land aside will be sufficient to achieve important reductions in grains."

Projections by the Economic Research Service suggest that the new programs offer "the possibility" of significant reductions in EC grain surpluses. However, these same projections also indicate that the grain production glut could grow with continued gains in yields, unless individual EC governments commit enough resources and political willpower to ensure that the programs work and that the EC's farm sector makes the structural adjustments necessary in the face of increasing productivity per farm.

Dairy Situation Severe

Dairy surpluses may be even harder to handle.

Despite recent moves to reduce milk surpluses, the EC's dairy sector seems headed for continued overproduction and large surpluses in the long term, says ERS economist David Kelch, who recently examined the EC dairy situation.

"This is likely to occur even though milk deliveries for 1988 are expected to decline by 3 percent, and foreign demand for milk protein has recently strengthened," says Kelch. "The central factors in future EC overproduction are the likely increase in productivity resulting from yield-enhancing biotechnology and the economic restructuring of the dairy industry, contrasted with stagnant or declining demand for dairy products."

He says technological advances—including embryo transplants, robot milking, and bST—will probably boost yields by 25 to 60 percent over the next few years. "New technology and the transfer of milk quotas will likely accelerate the trend to larger, more efficient dairy farms in the EC, while the dairy herd shrinks. On the demand side, demographic factors such as an aging population and a low or declining birth rate, in combination with health concerns about consumption of dairy products, all point to a continuing decline in demand."

The future surpluses will occur against a background of severe adjustments begun in 1984, says Kelch. "When milk deliveries exceeded quotas in 1985 and 1986 because of a low superlevy (a tax on production), the quota was reduced and the superlevy was sharply increased to 100 percent in 1987 and for the 1988/89 season."

He says milk deliveries appear to have declined by 5 percent for the 1987/88 season that ended March 31 of this year. Even so, deliveries exceeded the quota because of the high butterfat levels.

"The quota is based on fat content because more than half of the milk delivered is processed into butter and skim milk powder," says Kelch.

He adds that although the EC is expected to meet the next dairy quota cut of 2.5 percent in June 1988, temporary shortages of dairy products will exacerbate "internal pressure to raise prices and abolish or stabilize the quota in the 1990's, which will likely produce a buildup of butter and skim milk powder stocks in the long run." □

[Based primarily on information provided by economists David Kelch and Mary Anne Normile of the Agriculture and Trade Analysis Division, Economic Research Service, and economist Mark Newman, formerly with ERS.]

REPORTS IN THE NEWS

Soybean Boom: A Recent Event

Soybeans were introduced into the United States from the Orient in the early 1800's, but it took decades of selection and breeding before they caught on among farmers. The first crush of U.S. beans wasn't until 1914 in a cottonseed oil mill.

As more companies entered the soybean processing business in the 1920's, the crush for oil and meal expanded, and a new industry was born.

Growth accelerated in the 1930's and 1940's. By 1950, U.S. soybean plantings totaled 15.6 million acres, and production was 299 million bushels. Even that was just a hint of what was yet to come.

Among today's crops, only corn surpasses soybeans in the aggregate value of production. For every acre planted to soybeans in 1950, 4 acres were planted in 1986. With higher yields, 1986's production was more than six times as large as 1950's.

While the U.S. share of world production dropped from 74 percent in the late 1960's to 56 percent in the mid-1980's, Brazil and Argentina increased their combined share of world output from less than 3 percent to 24 percent.

Using narrative, maps, and around 50 data tables, this report provides a concise, yet detailed, look at the growth and current status of the U.S. soybean industry. Separate sections cover production, use, prices, marketing strategies, government programs, processing, storage and handling, market flow patterns, and world production and trade.

***The U.S. Soybean Industry** by Schaub, McArthur, Hacklander, Glauber, Leath, and Doty. (Published May 1988; 51 pages; GPO Stock No. 001-019-00584-0; $2.75.)*

Rural Elderly: Many in Poverty

For many older Americans, a move to the country represents an escape from urban crowds and an opportunity to stretch a comfortable retirement income. For others, however, growing old in rural America means getting by on a poverty-level income and meager resources.

Large numbers of people age 65 and over—7½ million in 1980—live in nonmetro areas, and their poverty rates are much higher than those of their metro counterparts.

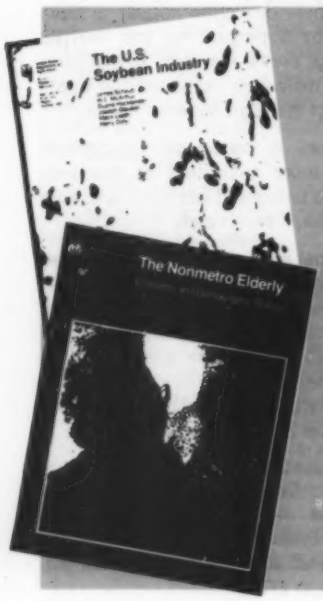
Altogether, the elderly make up 13 percent of the total nonmetro population, compared with less than 11 percent of the metro population. In 178 nonmetro counties, more than 20 percent of the population is 65 or older.

Although about 70 percent of the nation's elderly reside in metro areas, half of all older Americans with poverty-level incomes are found in nonmetro areas. According to this report, 21 percent of the nonmetro elderly were below the poverty line in 1980, nearly double the poverty rate of the metro elderly.

The differences in rates seem to be explained by a number of factors not directly related to location. Nonmetro elderly, for example, are more likely to be living alone and less likely to be working. In general, they have less education and lower paying job skills.

As the number of elderly continues to increase, nonmetro communities can expect to be faced with rising demands for public assistance and a growing need for medical and long-term nursing care facilities.

***The Nonmetro Elderly: Economic and Demographic Status** by Nina Glasgow. (Published June 1988; 35 pages of text, charts, and tabular data; GPO Stock No. 001-019-00570-0; $2.00.)*



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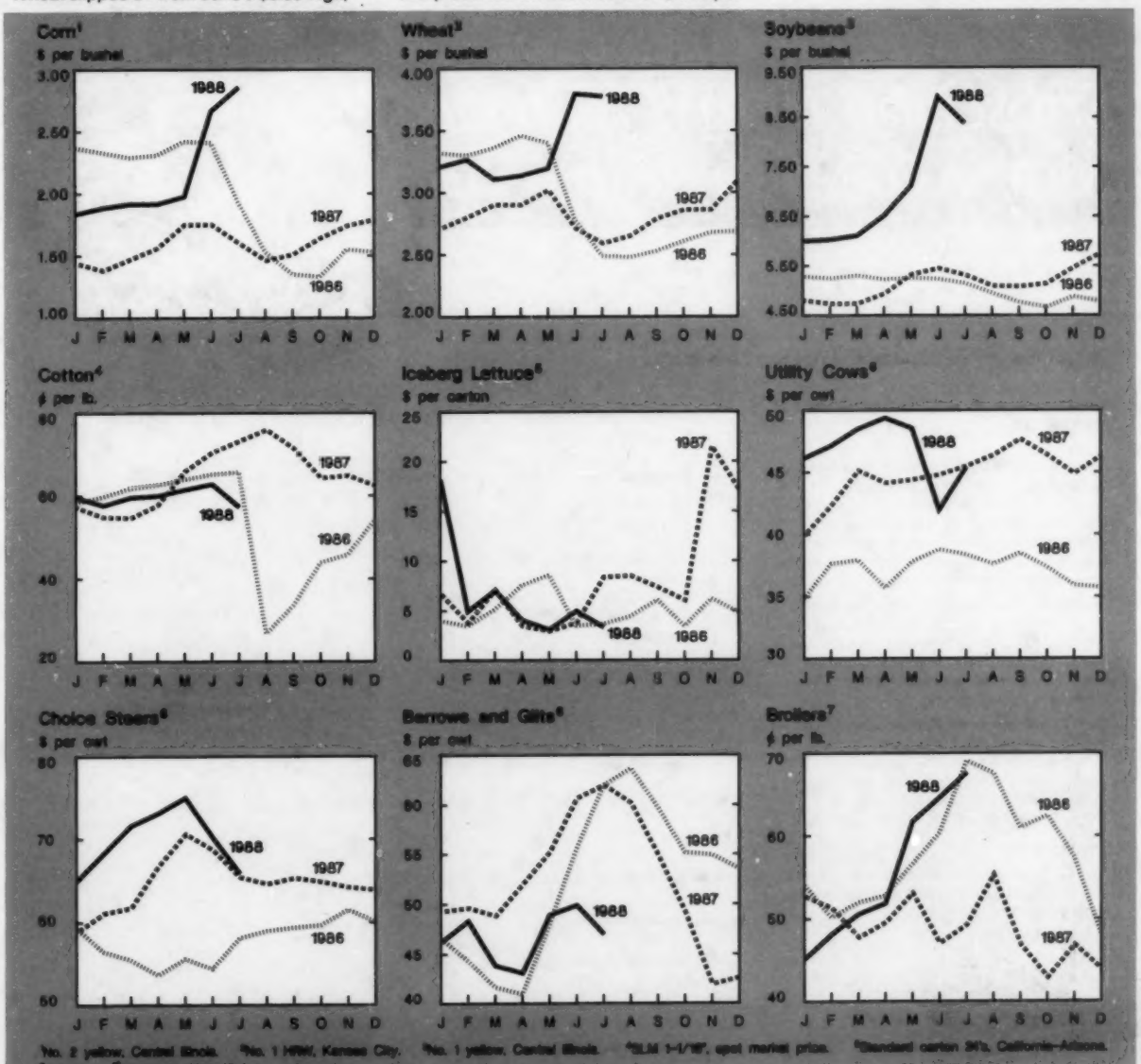
FARMLINE TRENDS

Monthly Price Monitor

USDA's July 1988 index of farm prices increased 3.6% from June and was 10% above its year-earlier level. Corn prices continued upward, reaching $2.86 per bushel, the highest since September 1984. Wheat slipped 2¢ from June's $3.80 high, and soybeans dropped 54¢ to $8.38 (still more than $3 above July 1987's price). Cotton, at 57.4¢ per lb., was the lowest in 15 months. In the meat animals area, utility cows strengthened to $45.41 after June's sharp decline. Choice steers fell $4.36 per cwt to $65.89, the lowest since January. Barrows and gilts dropped to $47.03, but broilers rose 3¢ per lb. to 67.7¢, the highest in 2 years. All prices shown are monthly averages.



[1]No. 2 yellow, Central Illinois. [2]No. 1 HRW, Kansas City. [3]No. 1 yellow, Central Illinois. [4]SLM 1-1/16", spot market price. [5]Standard carton 24's, California-Arizona. [6]Omaha. [7]Wholesale, New York.

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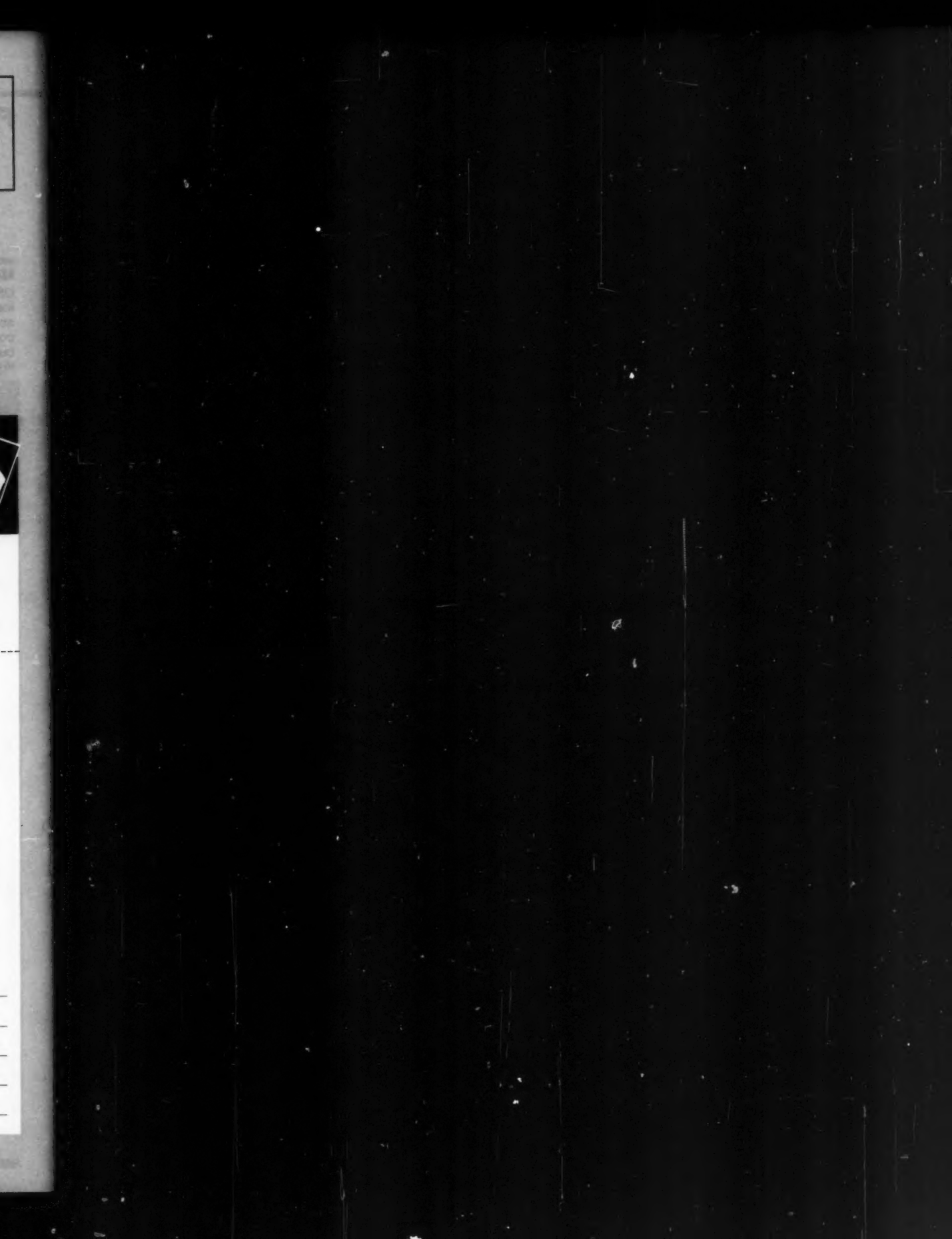
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